Workplace misconduct

The underestimated systemic implications for investors

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Foreword

Recognising the vital connection between workplace culture, human dignity, and business is essential, especially for investors dedicated to achieving both financial and ethical success. While these concerns may not always be at the forefront of decision-makers' agendas, there is a growing shift towards prioritising them, often influenced by evolving regulatory requirements. After all, the right to a safe workplace is a fundamental human right that belongs to us all.

Cultures that foster inclusivity and respect for individuals tend to align more seamlessly with financial stability and growth. Conversely, cultures that tolerate human harm also harbour financial risks for prospective investors. Although assessing the financial implications of workplace culture issues may appear complex, it is a necessary consideration. Quantifying risk involves comprehending individuals' experiences within these cultures and evaluating the systems and structures that either promote inclusivity or cause harm.

Investors are increasingly cognisant of how workplace culture significantly impacts a company's performance and reputation, with direct consequences for shareholder returns. This recognition empowers investors to drive positive change and champion investments that offer both financial rewards and positive human outcomes.

By introducing the concept of 'culture-based financial risks' and proposing a framework to comprehend them, this paper provides a means to elevate these concerns to the attention of C-suite executives and corporate boards as enterprise risks and as opportunities for growth and improvement. This is critical as leadership at the highest levels of organisations has an out-sized impact on culture.

This paper serves as a bridge between human rights, corporate culture, and their effects on businesses, the economy, and, consequently, investors. In addition, it acknowledges the potential for far-reaching consequences from social movements rooted in human rights, such as *#MeToo* and *#BlackLivesMatter*, and how evolving social norms can instigate positive changes within various systems.

Ultimately, this paper underscores the importance of recognising and addressing 'culture-based financial risks' by highlighting their implications for countries and economies. It encourages us to view these challenges as opportunities for proactive responses. For business leaders and investors committed to fulfilling their fiduciary duties while simultaneously upholding their ethical responsibilities to their workforce, clients, and stakeholders, this paper offers an inspiring and insightful read.

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Executive summary

‘It is the worst behaviours tolerated that shape culture.’

—John Amaechi OBE

Harmful behaviours in the workplace such as abuse, bullying, sexual harassment, discrimination, and victimisation are well understood to translate into company-level financial impacts. What is less understood are the financial implications of these behaviours to a broader portfolio as they extend past the individual company. Adding further complexity is how evolving societal movements interact with these dynamics and further impact financial outcomes.

In this paper, we explore how harmful behaviours can lead to ‘culture-based financial risks’ that are interrelated and can lead to vicious cycles across sectors and the economy. When harmful behaviours are pervasive in a workplace or across an industry, they create elevated levels of ‘culture-based financial risk’ which can lead to the loss of social licence to operate for both a company and the broader sector. These risks can also lead to externalities for societies and economies and are fundamentally a violation to human rights.

The cumulative nature of these risks can be particularly costly for universal investors who have undiversifiable exposure across multiple companies in a sector and are impacted by the beta risk of the whole economy.

In this paper, we propose a framework to holistically assess how ‘culture-based financial risks’ impact investors and identify three main categories of risk that are interrelated and create negative feedback loops:

- **Operational:** when incidents of harmful behaviour in the workplace, such as sexual harassment or bullying, impact a firm’s operating productivity and efficiency. The financial impact can be directly to revenue or expenditure.
- **Societal gap:** forms when there is a gap between a company’s culture and societal norms and expectations around harmful workplace behaviours. This gap is often driven by shifting societal expectations through social movements such as *#MeToo* or *#BlackLivesMatter,* as well as changes in regulation and enforcement attitudes. This type of risk can lead to stakeholder backlash as well as loss of reputation, with potential financial impacts related to ‘key person value’ loss, criminal penalties and litigation costs.
- **Systems:** when incidents permeate an industry or economy this can impact a sector’s social license to operate and a company’s access to critical inputs, such as human and financial capital. The financial implications manifest in higher input costs of production, and then more broadly generate economy-wide externalities which are borne by all stakeholders.

The framework also provides recommendations of what actions and disclosures companies should undertake to help with the assessment of these risks. We conclude that the approach to managing culture-based financial risks needs to shift beyond human resource departments to the enterprise risk level, with greater visibility and accountability from CEOs and boards.

1 Introduction

Company culture has been in the spotlight for a number of years, with growing recognition of the importance of culture within an organisation, and its contribution to an organisation's risk profile. It is now widely recognised that weaknesses in culture, and the governance and accountability relating to culture, translate directly into financial risk.

In this paper, we assess how harmful behaviours like abuse, bullying, sexual harassment, discrimination, and victimisation in the workplace translate into financial risks for investors and an economic cost to society.[1] When these behaviours are pervasive in a workplace or across a whole industry, they create elevated levels of what we define as 'culture-based financial risk'.

Traditionally, investor engagement on these issues has been focused on human resources-related strategies that can be leveraged to improve company culture. These strategies include appropriate diversity and inclusion practices, creating a 'speak up' culture, survivor-centric grievance mechanisms, among others. We fundamentally support and encourage these initiatives and believe they are a critical way to improve workplace culture. In parallel, this paper seeks to add another lens to understanding culture and focuses on the risk elements associated with a poor company culture.

'Culture-based financial risks' refer to the probability of negative impacts that harmful behaviours in the workplace can have on a company's productivity, reputation, and social license. They can also lead to externalities in the economy and society.

In this paper, we seek to cover three key objectives:

1. Highlight the challenges of assessing culture-based financial risks for investors;
2. Provide a framework to begin assessing these risks across portfolios; and
3. Outline recommendations to companies on how they can address these risks.

We have developed a framework to help investors understand these risks and the potential financial implications. While putting a value on the total cost of culture-based financial risks is challenging, we outline examples below of some of the financial consequences when these risks are mismanaged. We hope the framework will assist investor understanding of what we believe are understated risks and help to identify metrics, information and action needed from companies to improve the risk assessment process.

1.1 Methodology and limitations of the paper

The framework has been developed through collaboration between several institutional asset owners and asset managers to highlight the investor lens on these culture-based issues. The framework and subsequent recommendations have been informed by consultations with companies, subject matter experts, legal institutions, topic specialist think tanks, and industry associations, as well as desktop analysis of existing research.

We acknowledge limitations with our approach, including the emerging nature of research into culture-based issues as risks to investors, as well as limitations with data and correlation analysis to financial performance. In addition, our consultation was not centred on employees who are most impacted by these incidents. Nevertheless, we believe that the framework provides a comprehensive foundation for investors to begin assessing these risks. A foundation that we anticipate will only improve in time if company disclosures increase and if action is taken by companies to manage these culture-based issues.

The right of workers to be free from harmful workplace behaviours is considered a human right, a workplace right and a safety right. While this framework focuses on the financial implications of culture-based financial risks, it should be considered within a broader human rights context. Fundamentally, as investors we have responsibilities to respect human rights in our own operations and supply chains, as well as in our direct and indirect investments. This framework is meant to help guide investors to conduct greater due diligence into human rights breaches in the form of harmful workplace incidents and play a role in remediation.

1 ILO defines harmful behaviours within the context of 'violence and harassment in the world of work', which cover a broad range of unacceptable and unwelcomed actions and behaviours that aim at, result in, or are likely to bring harm to an individual and create a hostile environment.

1.2 The current challenge: Why are culture-based financial risks underestimated by investors?

While there is broad recognition of the importance of culture in assessing a company's future performance, it is still difficult for investors to:

1. Assess company culture from the outside; and
2. Quantify the potential financial risk posed to an investment portfolio by harmful workplace behaviours.

Difficulty with assessing company culture from the outside

Currently, there is little information in the public domain that gives investors insight into how boards and management assess key measures of corporate culture. A key challenge is the intangible nature of culture and the subjectivity that surrounds it.

Reporting standards and disclosure tools do not provide an effective way for investors to track a company's exposure to culture-based financial risks and do not allow investors to assess how effectively companies are mitigating these risks. Most metrics provided are backward-looking, show an aggregate view of the health of the company's workforce and are input oriented.

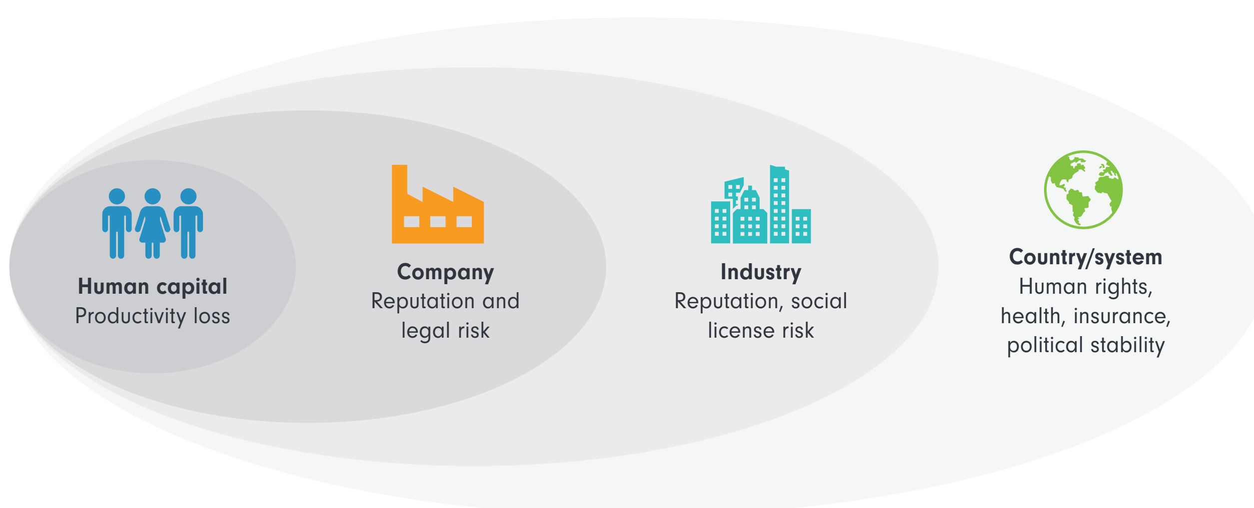
Difficulty with assessing a portfolio's culture-based financial risk exposure

Historically, the majority of culture-based financial risk analysis has been focused on company level implications. Investors have viewed the risks in isolation and only assessed the impact of these risks to the company's productivity and financial performance. However, when taking a universal investor lens to culture-based financial risks we realise that harmful behaviours in the workplace can have much wider reaching implications than initially thought.

For the purposes of this paper, we define 'universal investors' as diversified asset owners such as pension funds, university endowments, and sovereign wealth funds that own a representative share of the entire economy and therefore have an interest in the long-term health of the financial system. Universal investors cannot diversify away from systemic risks such as climate change and culture-based financial risks and can only mitigate whole-system threats by effecting change in the real economy.[2]

We posit in this paper that company specific issues can quickly lead to sector-wide and portfolio-wide implications that can create vicious cycles and cumulative risk for investors. We believe that the extent of these impacts and the interrelated nature of these risks are currently not fully considered or quantified by investors.

Figure 1. Layers of culture-based financial risks that impact investors



Source: Fidelity International, October 2023

2 Dr. Ellen Quigley, Universal Ownership in Practice: A Practical Investment Framework for Asset Owners.

2 A framework to understand culture-based financial risks for investors

For investors to holistically assess culture-based financial risks, we have developed a framework (see Figure 2) that captures the three categories of risk that can lead to the most material financial implications. These three types of risks include: operational, societal gap and systems-level.

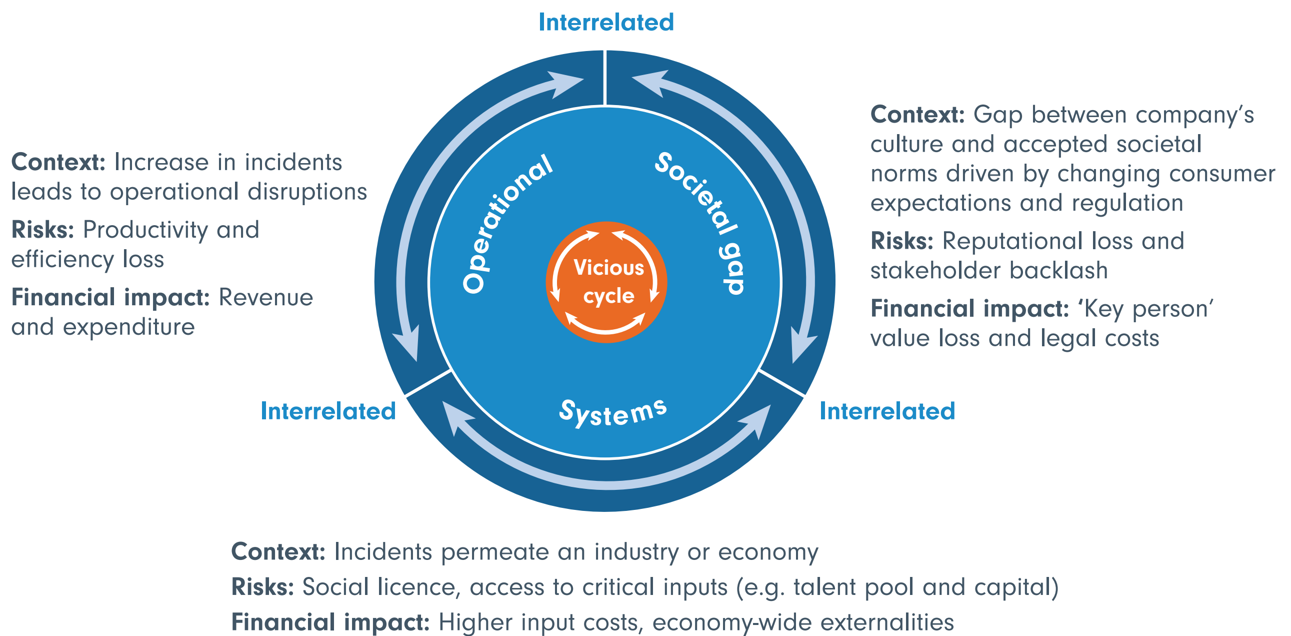
Investors familiar with frameworks used to assess the financial risks of climate change, such as the Taskforce for Climate-related Financial Disclosure (TCFD), will notice that we have borrowed elements of these disclosures when thinking about culture-based financial risks.

As highlighted in Figure 2, the majority of current financial analysis conducted on culture-based issues largely sits in the 'operational' risk category which describes unilateral risk at the company level.

With this framework, we can now assess the broader risk categories of 'societal gap' risk as well as 'systems-level' risk to develop a fuller picture of the potential risk exposure for investors at the portfolio level.

In addition, investors can also better understand the connection between these interrelated risks and the potential contagion effect. For example, company-level incidences (operational) can lead to negative perceptions of a sector (societal gap), which in turn impact the sector's social license to operate (systems-level). They can then lead to long-term and material impacts on economic productivity. The interconnected and additive nature of these risks can then form a vicious cycle for communities and economies.

Figure 2. Types of culture-based financial risks and the interactions between them



Source: Fidelity International, October 2023

2.1 Operational risks – company-level impacts

From an operational perspective, incidents of harmful behaviour in the workplace, such as sexual harassment or bullying, impact a firm's operating productivity and efficiency. These incidents can absorb an organisation's time and resources and lead to higher levels of absenteeism and lower presenteeism. These conditions also lead to higher turnover and disengagement across the workforce. All of which directly impact productivity.

As Deloitte highlighted in their *Economic Costs of Sexual Harassment in the Workplace* report, the estimated annual cost of sexual harassment to workplaces in Australia is A$2.6 billion in lost productivity.[3] Staff turnover costs, absenteeism, and manager time largely drive these losses. These incidents can also lead to higher workers' compensation premiums. Companies may also need to provision for additional capital expenditure to improve their workspaces to enable a safe working environment and speak up culture (e.g. surveillance and security and training programs).

While the financial impacts of culture-based operational risks may be hard to fully quantify, investors are able to use proxies such as absenteeism and turnover rates to approximate the direct impact to the company. A good example of this type of financial impact analysis, is recent research published in the Journal of Business Ethics investigating the extent to which sexual harassment impacts a company's value. The authors of *How Much Does Workplace Sexual Harassment Hurt Firm Value?* highlight that the sample of companies with unusually high sexual harassment (SH) scores exhibit significant reductions in future stock performance and profitability. For example, firms with a top 2% SH score earn a value-weighted risk-adjusted stock return of -17% in the one-year period after the high-SH classification. Furthermore, these firms experience a decline in operating profitability and an increase in labour costs during a five-year period around the high-SH classification. The evidence in the report suggests culture-based financial risks, such as sexual harassment, can cause greater damages to firm value than previously documented.[4]

2.2 Societal gap risks – company cultures falling behind

Societal gap risk describes the risk that emerges following evolving societal expectations, shifting consumer preferences and regulatory and legal developments. Social movements, such as the *#MeToo*, *#TimesUp* and *#BlackLivesMatter* movements, which started in the US but spread around the world, have exposed companies to this risk. These movements highlight a change in social values and norms, which make previous behaviours, actions, and internal company cultural norms no longer acceptable. Stakeholders are now holding companies accountable for their social license to operate, demanding greater alignment between management and boards and broader society. Furthermore, these social movements have in turn become part of the political agenda in many countries and have influenced legislative change, such as the *Respect@Work Bill* in Australia, the *Worker Protection Bill* in the UK, and the *Ending Forced Arbitration of Sexual Assault and Sexual Harassment* and *Speak Out* Acts in the US.

Despite the prevalence of culture-based financial risks in workplaces, we found that the relationship between the extent of the misconduct and its impact on a company's share price performance is not always proportionate. In other words, negative share price performance is not necessarily caused by the incident's severity, but instead by the perception of the incident. This perception is impacted by several factors including a company's visibility, regional cultural norms, and global trends on acceptable workplace behaviour.[5] The perception of the incident is further exacerbated when it is revealed that companies have used historical financial settlements with survivors and perpetrator-driven non-disclosure agreements (NDAs) to cover up incidences of misconduct. Therefore, we suggest that social movements 'activate' dormant risks within companies that have high visibility and are in jurisdictions of rapid societal norms change.

3 Deloitte, The economic costs of sexual harassment in the workplace.
4 Journal of Business Ethics, How Much Does Workplace Sexual Harassment Hurt Firm Value?
5 Criterion Institute, A Framework for Screening Portfolios for Risks Posed by Gender-Based Violence.

Returning to the climate risk analogy, societal gap risks are very similar to climate change transition risks. As the world transitions to a low carbon economy there are expected to be extensive changes in policy, legal, technology and societal expectations which may form risks for companies. As a society becomes more progressive, the societal gap risk increases for companies whose cultures are lagging, thereby creating the potential for 'stranded asset' risk. We characterise stranded asset risk in this context as the experienced individual who was originally seen as valuable to the company and a potential contender for a senior leadership position, but as societal norms changed and historical incidents came to light, management decided to unexpectedly or prematurely 'write-down' the individual's value to the company. In this case, the individual's value could no longer be fully realised, as promoting and retaining the individual would pose too much risk to the company and its reputation. The value and investment put into the individual may be lost or 'stranded', which can also result in loss of company value. On the following page are two company case studies of 'culture-based stranded asset risk'.

Societal gap risks, much like climate transition risks, are somewhat unpredictable and given the scale of the impacts they are hard to calculate. For investors, we can use indicators that assess changes in consumer preferences as well as shifting societal norms. Still, there are no consistent methodologies, and it is hard to predict the direction and impact of future social movements.

These risks can manifest in many ways, including reputational loss and consumer and employee backlash. Other material financial impacts occur when there is 'key person risk' and the individual is either involved in the incident or its mismanagement. These instances can result in the removal of senior company leadership such as the CEO, board members, and senior management.

Recent academic research showcases the financial impact of societal gap risks for companies, with a specific focus on sexual harassment incidences. In the *#MeToo: Sexual harassment and company value* report, the authors identify that the average effect of a sexual harassment scandal on company value is around a 1.5% abnormal share price decrease over the event day and the following trading day. In the cross-section analysis, the authors note that the effect is considerably amplified when the CEO is involved in the scandal and there is high news coverage, but they highlight it can be somewhat mitigated if a firm provides self-disclosure of the misconduct. The report finds that the average magnitude of impact was unchanged before and after the *#MeToo* movement. Nevertheless, the frequency of scandals in the media translates to a four-fold increase in the risk of a company becoming embroiled in a scandal. Proxies of public sentiment rather than direct penalties and loss of productivity have been found to correlate with the magnitude of the impact.[6]

6 Journal of Corporate Finance, *#MeToo: Sexual harassment and company value.*

Case studies

Case study – AMP Capital
When a CEO becomes a 'stranded asset'

In 2020, AMP Capital, a global investment manager based in Australia, announced the promotion of the global head of infrastructure equity, Boe Pahari, to chief executive of the group. While the sexual harassment case against Boe Pahari had been settled and closed years prior, the societal gap risk remained with the individual as he was promoted through the organisation. It was evident that society's values had shifted, and it was no longer viewed as acceptable for leaders of large publicly listed organisations to have perpetrated such behaviour.

In this case, we believe the risk was not properly quantified and qualified by the board when they appointed Pahari to CEO. The investment in, and responsibility given to the individual was inextricably tied to the company's reputation and value. Following media reports of the historical settlement, AMP's share price fell, and investor and client pressure resulted in his removal and departure from the position. However, the damage had already been done, and the company lost many of their largest clients and top talent.[7]

Case study – CBS Broadcasting Inc.
When an NDA triggers an investor class action

In late 2018, the former chairman and CEO of CBS, a US television network, Les Moonves resigned following revelations that he perpetrated serial sexual abuse over more than a decade. Moonves was widely considered a titan of the entertainment industry and was well known for his hands-on approach as a corporate executive. As CEO over 15 years, he was credited for having resurrected what was at the time a fading company to make it the most watched network of the 2010s. During his tenure, the company's share price went from $5 to nearly $70 in 2017, and the network produced several popular hits such as The Big Bang Theory and How I Met Your Mother.

The story of his personal misconduct was broken by media during a period when there was an acute focus on the public reckoning of companies with sexual misconduct in the United States, increasing public interest in the news. Following the revelations, CBS' share price materially declined resulting in significant value loss for shareholders.

Off the back of these events, in August 2018, CBS shareholders brought forward a securities class action case against the company, claiming that they had been lied to about how the company was handling sexual misconduct which resulted in the subsequent company value loss when the harassment claims were surfaced. Paramount, which now owns CBS, agreed to investor demands and paid US$14.75 million to resolve the class action against the company.[8]

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7 AMP's Boe Pahari paid a $2.2m penalty (AFR), Pahari fallout threatens AMP's super fund rivers of gold (AFR) and QSuper yanks $400m ethical mandate from AMP (AFR).

8 Paramount, Moonves settle CBS shareholder *#MeToo* class action for $14.75 mln (Reuters).

Global regulatory developments on culture-based issues

Around the world, governments are seeking to improve worker protections from culture-based risks. The clearest example of government action on culture-based issues is in the area of gender-based violence and sexual harassment. Over 122 countries prohibit sexual harassment in the workplace and 116 extend this protection to both women and men.[9]

Recent regulation in the UK, US, Ireland, and Australia underscore the focus from governments on supporting better protections for employees from harmful workplace behaviours. Key developments in legislation include appropriate use and management of NDAs, as well as preventing employers from forcing workplace misconduct cases down arbitration routes. Another key development that has precipitated in the last few years is around the introduction of 'positive duty' on employers.

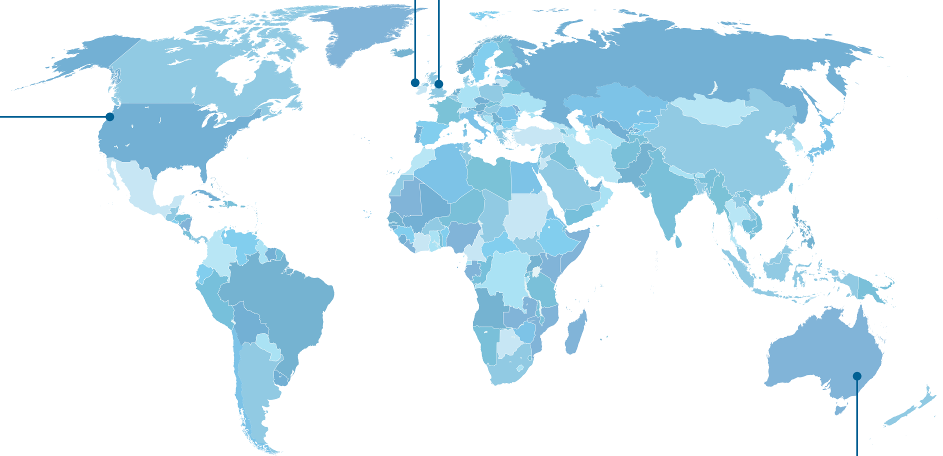
The concept of 'positive duty' marks an important change that requires employers to focus on preventing workplace sexual harassment and discrimination, rather than being reactive to these issues. It imposes a legal obligation to take proactive and meaningful action to prevent workplace sexual harassment, victimisation, hostile work environments, and other forms of sex discrimination from occurring.

The introduction of a positive duty is expected to increase the risk of litigation and claims against an employer, as well as impose greater insurance costs for certain high-risk companies making this a clear financial risk for companies. New legislation may also bring increased public and media attention to workplace sexual harassment cases, increasing the reputational risk for companies.

Ireland: The Irish government is debating the Employment Equality (Non-Disclosure Agreements) Bill, which restricts the use of NDAs, preventing them from being used to cover up harassment and other criminal activities in the workplace.

United Kingdom: In the UK, the government is supporting amendments to the Worker Protection Bill to better protect employees from workplace harassment, shifting the focus from redress to prevention. Further, since 2018, the UK Corporate Governance Code encourages boards of UK listed companies to report to their assessments of corporate culture, going beyond employee engagement surveys, as well as ensure accountability for culture at the Board level.

United States: In the US, several states have passed new laws protecting workers from sexual harassment and in 2022 alone, a number of bills were passed to restore the voices of survivors by invalidating NDAs, as well as preventing employers from forcing cases down arbitration routes (e.g., Ending Forced Arbitration of Sexual Assault and Sexual Harassment Act and the Speak Out Act).



Australia: In Australia, the passage of the Respect@Work Bill in October 2022, has led to regulators, investors and other stakeholders demanding more transparency around the measures companies are adopting to prevent and respond to sexual harassment. In December 2022, the Bill also introduced a 'positive duty' on all employers in Australia to take all reasonable steps to prevent workplace sexual harassment, sex discrimination and sex-based harassment.

9 Sexual Harassment in the Workplace: a Global Challenge, Legal 500.

2.3 Systems risks – cumulation of company-level risk

The accumulation of company-specific risks can lead to systems-level risks which manifest in two ways: social license to operate and cost to society.

When harmful behaviours are prevalent across several companies in the same sector this can impact a sector's social license to operate. The loss in social license can mean that an entire sector will face increased barriers to accessing critical inputs for production. Human capital resource is one such example, but other inputs can also become challenging to obtain such as access to financial capital and regulatory approvals. When culture-based financial risks become a systems-level risk, the sector or company may receive additional scrutiny from stakeholders, including governments, consumers and civil society.

In addition to social license considerations, cumulative culture-based financial risks across a sector can lead to externalities for an economy. Harmful behaviours in the workplace are borne not only by individuals and companies but also by governments and society. A recent report by Deloitte estimates that approximately 30% of the annual cost of sexual harassment in workplaces in Australia is borne by the government and society.[10] The externalised costs of culture-based financial risks may include costs to the legal and justice system, increased healthcare costs as well as higher government spending on welfare payments and reduced tax revenue from affected individuals and companies. These externalities have deeper impacts for investors that are invested across multiple companies and sectors, and the subsequent systemic risks cannot be mitigated through divestment or diversification.

10 Deloitte, The economic costs of sexual harassment in the workplace.

Case study of the three levels of risk: the Australian mining sector

Mining in Australia has long been, and continues to be, a significant contributor to the Australian economy. Despite its importance, in recent years the sector has come under increasing scrutiny around its 'social license to operate', particularly its management of culture-based financial risks.

In the 2018 Australian Human Rights Commission's report, mining was called out as one of the top five industries with the highest prevalence of workplace sexual harassment. The release of Rio Tinto's *Everyday Respect* report, conducted by Elizabeth Broderick & Co, and the Western Australian Parliament's *Enough is Enough* report, further highlight that harmful workplace behaviours have long been and continue to be prevalent across the mining industry.

We chose the Australian mining sector as a case study for the impacts of culture-based financials risks as there are clear examples across the sector of the manifestation of the three levels of risk.

Operational risks in the sector

According to the Australian Productivity Commission, when comparing the mining sector to other industries such as manufacturing and business services, labour productivity has remained largely flat in recent years.[11] While the weakness in productivity can be largely attributed to lower investment in the sector and challenges with securing talent, we posit that culture-based issues may have also played a role in the improvement of operational productivity. In the last few years, the sector has seen higher absenteeism levels and turnover rates driven by several sector-specific issues, which may have been contributed to by culture-based issues.

In addition to lower productivity levels, miners have also had to allocate additional capital towards improving their facilities and ensuring safe working conditions. For example, after defining sexual assault and harassment as a safety risk, BHP allocated A$300 million in FY22 to implementing security upgrades across their sites. These improvements included guards, CCTV, and lighting to reduce the incidents of misconduct and ensure the safety of their female workforce.

Societal gap risk in the sector

Public perception of Australian mining is catching up with the sector, highlighting the disconnection between company cultures and the changes in societal norms and expectations. An example of this dislocation was when Newcrest Mining's CEO Sandeep Biswas came forward in February 2022 and conceded that his leadership style had been too 'autocratic' in his early tenure as CEO and needed to change to suit modern standards.[12]

He vowed to make Newcrest a more inclusive, respectful and 'psychologically safe' workplace. However, less than twelve months after the initial comments, Mr Biswas made a sudden departure which led to increased turnover across Newcrest's senior leadership team. While this incident did not have a material impact on the company's share price, the implications are likely to be seen in operational performance and reputational impacts, off the back of societal gap risk and 'key person' value loss.

Systems level risk in the sector

Systems level risk has potential implications for issues such as labour shortages and talent retention, as adverse coverage could impact the attractiveness of the sector as a career choice. While we do see positive steps being taken, it's important that the sector keeps moving forward collectively. Companies need to focus on building a purposeful brand that aligns with today's societal values in order to attract and nurture talent for the future.

11 Australian Productivity Commission, 2023 Bulletin.
12 Newcrest culture probe lobbed before Biswas exit (AFR).

3 Recommendations for investor portfolio level culture-based financial risk assessment

To assess portfolio-level risk exposure to culture-based financial risks, we believe there are three leading indicators for these risks, namely: country, industry, and workplace conditions.

On country level risk, the social and regulatory landscape in a particular jurisdiction increases the potential for societal gap risks to occur in an organisation. Example jurisdictions would include Europe, United Kingdom, Ireland, United States and Australia. Recent research by the Criterion Institute showcases the high correlation of culture-based financial risks, particularly gender-based violence data, with political risk analysis. Their research provides evidence that rates of violence against women are a better indicator of state stability than many traditionally used measures, such as wealth and the strength of institutions.[13] As a result, for universal investors, understanding social movements, consumer preferences and gender inequalities are likely to be critical tools to assessing country level risk.

At the industry level, certain sectors are associated with higher prevalence rates of culture-based issues, including workplaces that are hierarchical, male-dominated, client-facing and have 'high-value' or 'indispensable' workers. High-risk industries include mining, construction, media, technology, financials, retail, healthcare, and hospitality.

Finally, certain workplace structures or conditions lead to a higher risk profile. For example, workplaces with a higher contracted workforce, lack of diversity, that operate in isolated and remote areas or allow higher levels of alcohol consumption activities tend to have a higher prevalence of culture-based issues. As a result, investors can use these three indicators to assess the culture-based financial risk across their portfolios, highlighting potential areas of concentrated risk, and begin to quantify the financial impacts of the cumulative risks.

In addition to risk assessment, investors can use engagement and public policy advocacy to encourage appropriate disclosure and action from companies that go beyond policies and self-assessments. Section 4 of this paper walks through our key recommendations on the asks and expectations of companies, which include appropriate governance mechanisms, senior oversight, as well as proper incentive structures.

13 Criterion Institute, Gender-Based Violence: A Hidden Indicator of Political Risk.

4 Bridging the gap between companies and investors: Recommendations for companies

4.1 The company challenge: Framing culture-based financial risks appropriately

This paper has largely focused on the challenges investors face when assessing culture-based financial risk. Nevertheless, we also wanted to highlight the current challenges that companies face when seeking to manage these risks. While there are a range of factors, we believe the fundamental challenge companies face is the inappropriate framing of culture-based financial risks within the organisation. Through our research, we have identified three key elements that impact the consideration of these risks:

1. Not treated as business-critical risks;
2. Lack of organisation-wide and aggregation of workforce tracking mechanisms; and
3. Lack of accountability across senior leadership.

Currently, culture-based financial risk incidents are not generally treated with the same level of priority as other business risks, such as physical safety. While workplace safety is often a key constituent of a company's enterprise risk management framework, most companies do a poor job of capturing psychological safety and culture-based risks in these mechanisms. We believe this omission makes it more challenging for companies to holistically manage these risks.

While many companies have adopted organisation-wide tools to track human capital metrics, the extent of their use and sophistication varies materially. We understand from companies that many don't have the necessary tools or structures to track the data or are only beginning to collect the data. Without having useful and granular organisation-wide human capital information, managing culture-based financial risk can be challenging and uncovering potential risk areas nearly impossible.

Finally, culture-based issues have traditionally been managed by human resource departments and are often handled with a legalistic response. We believe this narrowcasting of the risks constrains a company's ability to manage them appropriately. Culture-based financial risks impact an entire organisation, and their management needs to be part of a CEO's, senior leaderships', and Board's accountability.

4.2 Recommendations for company-level action and disclosure to help assess culture-based financial risk

By assessing companies across the three levels of risk – operational, societal gap and systems level – we believe it is a more holistic way to assess a company's exposure to and management of culture-based financial risks. Again, borrowing framing from the Taskforce on Climate-related Financial Disclosures, we outline in Table 1 (following) our recommendations for these three levels of risk across governance, strategy, risk management and metrics and targets.

The recommended actions and disclosures outlined above are by no means exhaustive, though we believe are fundamental to appropriately manage culture-based financial risks.

Alphinity (An Australian Asset manager) and HESTA (an Australian Superannuation fund) have previously conducted extensive research (here and here) on the governance and metrics elements that would complement the recommendations below. Their frameworks are tailored to the Australian mining sector, though the majority of the recommendations would be very transferrable to other high-risk sectors. We would encourage companies and other stakeholders to review their frameworks to understand a broader set of metrics and example disclosures.

Table 1. Summary recommendations for company-level action and disclosure on culture-based financial risks

<table>
<tr><th rowspan="2">Culture-based financial risk</th><th>Governance</th><th>Strategy</th><th>Risk management</th><th>Metrics and targets</th></tr>
<tr><th>Disclose the organisation's governance around culture-based financial risks</th><th>Disclose the actual and potential impacts of culture-based financial risks on the organisation's businesses, strategy, and financial planning where such information is material</th><th>Disclose how the organisation identifies, assesses, and manages culture-based financial risks</th><th>Disclose the metrics, targets and milestones used to assess and manage relevant culture-based financial risks where such information is material</th></tr>
<tr><td>Operational</td><td rowspan="3">Board and management oversight
Clear accountability across senior leadership
▪ Remove sole responsibility in HR and broaden scope
Incentive structure
Link culture-based issues and psychosocial safety to remuneration
Design
Incorporate culture-based considerations into design of all policies and strategies
Gap assessments
Remain informed of emerging social movements and how they might impact operations and business strategy, including gap assessments between societal expectations and company culture</td><td>Curation
Foster a 'speak up' culture and reduce characteristics of high-risk cultures
Training
Robust training and awareness programs
Partners
Ensure outside organisation stakeholder inclusion (e.g. contractor workforce)</td><td>Risk register
Elevate culture-based financial risk to company Enterprise Risk Management (ERM) framework</td><td>Disaggregation
Disaggregated human capital data
Engagement
Employee engagement survey results detail
▪ Incorporate 'speak-up' content
Remediation
Complaints, incidents, and disciplinary actions</td></tr>
<tr><td>Societal gap</td><td>Transformation
Cultural transformation strategies and milestones</td><td>External audits
Third-party culture assessments</td><td>Seniority
Level of seniority of the incidents
Severity
Assessment of the level of severity of the incidents
Use of NDAs
Policy on the use of NDAs and disclosure of historical agreements and settlements</td></tr>
<tr><td>Systems</td><td>Collaboration
Industry-wide initiatives to elevate culture-based financial risk considerations</td><td>Benchmarks
Develop sector-wide framework/benchmark and best practices to elevate risk management</td><td>Capacity building
Programs, activities, benchmarks as well as funding for sector-wide initiatives</td></tr>
</table>

4.3 Detail on recommended company-level action and disclosure for culture-based financial risks

Governance framework across all levels of risk

As highlighted by Alphinity and HESTA, boards and senior management have the responsibility to embed comprehensive oversight of culture-based financial risks. As we noted above, these risks should no longer sit only in HR departments but instead there should be clear accountability for managing these risks with the CEO and the board. Further, boards should keep abreast of emerging social movements and ensure that the culture within their organisation is resilient and compatible with future cultural shifts.

In addition, if culture-based financial risks at the company or industry level are acute, we believe it also prudent to have remuneration and performance incentives appropriately and transparently tied to the management of culture-based financial risks.

Finally, we would encourage integrating a culture-based lens into the design of all policies and strategies. This includes considering the impacts of culture-based financial risks on the organisation's business units, strategies, and financial planning.

Operational

From an operational perspective, we have identified six key focus areas for companies in managing culture-based financial risks.

Across strategy, we would encourage companies to:

- Foster a 'speak up' culture and seek to reduce or eliminate characteristics of a high-risk culture.
- Develop robust training and awareness programs, as they are a key leading indicator of an organisation's cultural transformation strategy. Investors encourage organisations to provide more detail on the type of training programs, the workforce participation as well as whether training is extended to close stakeholders of the company, such as contractors.

In terms of risk management:

- Culture-based financial risks should be elevated to a company's Enterprise Risk Management framework and actively monitored, with clear accountabilities for board reporting.

From a disclosure perspective, we would recommend companies provide:

- Human capital data that is disaggregated so investors can assess potential risk areas across specific workforce demographics. Types of disaggregation include gender, ethnicity, seniority, and location. We note that in certain jurisdictions disaggregation of data is prohibited, nevertheless we would encourage companies to explore ways to share this data in a decision-useful way.
- Employee engagement surveys that include psychosocial and 'speak up' related content to ensure they are asking the right questions and uncovering any areas of risk. More granular information on the content of these surveys and key trends is critical information for investors.[14]
- Disclosure around complaints, incidents and the subsequent disciplinary action demonstrate the cultural health of an organisation and a company's willingness to be transparent. We recognise that there might be sensitivities around disclosing incidents that are not yet substantiated on an annual basis. However, for investors, the fact that there are incidents being investigated, communicates the existence of a 'speak up' culture which we would interpret in a positive light. When companies in high-risk sectors embark on a process to improve their cultures, we would expect the number of investigations to increase in the short term, before plateauing and then declining in the medium to long term as these culture-based issues are remedied through time.

14 Leka, S and Cox, T. The European Framework for Psychosocial Risk Management: PRIMA-EF.

Societal gap

As highlighted previously, societal gap risk at the company level is challenging to assess as it is impacted by shifting cultural norms and a society's perception of the incidents. Understanding how culture and perceptions are changing regarding workplace behaviour are the most critical indicators to assessing this type of risk but are also one of the most poorly understood and researched areas.

Nevertheless, we have identified four key areas through which companies can demonstrate proactive management of culture-based financial risks which we believe places companies in the best possible position, regardless of future societal norms changes. Notwithstanding, companies should proactively monitor and assess changes in cultural norms and adjust their strategies as required.

On strategy, we recognise that managing culture-based financial risks can take time and cultural transformation does not happen overnight. As a result, we would encourage companies to develop culture transformation plans and strategies. These plans should allow stakeholders to assess the 'how' of the cultural transformation and provide clear milestones to track progress towards the desired culture outcome.

In terms of risk management, we would recommend the formalisation of external third-party assessments of company culture. A qualified third-party auditor can help identify key risk areas and assist with developing a 'speak up' environment. An assessor is likely to have experience across multiple company cultures, thereby enabling them to recommend best practices. Further, they are likely to be more attuned to emerging social movements and trends, which will enable the company to be on the front foot and ensure senior leadership is across these changes, which may be underappreciated by internal company teams. In the US, investors are already acting in this area and there have been a considerable number of sexual harassment shareholder resolutions lodged with large companies, such as Comcast/NBCUniversal, Microsoft, Walmart, Alphabet and Amazon. These resolutions have sought to introduce independent investigations into company failures to prevent workplace sexual harassment by undertaking third-party assessments.

In Australia, Rio Tinto released their *Everyday Respect* report, providing an independent review of their workplace culture. The report was spearheaded by former Australian Sex Discrimination Commissioner Elizabeth Broderick, who published the findings and recommendations to address the incidence of harmful behaviours across their global operations. This transparency has helped investors better understand culture-based financial risks and, crucially, highlights the importance of an impartial third-party review of a company's culture.

Finally, on disclosure, we would encourage companies to provide the following information (though mindful of privacy and confidentiality requirements, particularly for survivors):

- Firstly, on the disclosure of incidents, we believe it is important to understand the level of seniority of the offender and the severity of the incident. By understanding the context of seniority and severity, investors can assess the level of risk tied to the incident, as well as the potential 'key person' risk latent in the organisation amongst senior leadership.

  To note, in this section we are focused on the level of seniority to highlight the societal gap risk element in order to assess the financial materiality of potential stranded asset risk across an organisation's senior leadership. Nevertheless, we acknowledge that misconduct at any level of an organisation is harmful and can lead to financial implications. The focus on seniority is not intended to understate the harmful implications of widespread workplace misconduct.

- The second focus area is on NDAs and the prevalence of historical financial settlements. Confidentiality obligations tied to NDAs and similar agreements can be harmful if perpetrator-led, and could be counter-productive to eliminating culture-based issues. When they are not survivor-led, NDAs can silence survivors, conceal harmful behaviours across an organisation, and inhibit oversight by boards and other stakeholders through preventing fulsome and transparent reporting. Therefore, we encourage companies to establish a clear policy on their use of NDAs as well as adopt best practices when considering the use of confidentiality clauses in employment agreements, for example using the *Australian Human Rights Commission's Guidelines on the Use of Confidentiality Clauses in the Resolution of Workplace Sexual Harassment Complaints.*

Systems

At the systems level, company-level action in isolation can be less impactful. To resolve this, we would encourage sector-wide collaboration to drive awareness and elevate risk management of culture-based financial risks. Industry-wide cooperation can help to develop:

1. Best-practice training programs;
2. Workplace standards for physical and psychosocial safety;
3. Industry-specific disclosure frameworks; as well as
4. Coordinated monitoring and reporting of harmful workplace behaviours and incidents.

5 Conclusion and call to action for investors and companies

While an organisation may be a leader on culture-based risk management, if a sector has lost its social license to operate then that organisation may still be impacted by association. To parallel Peter Drucker's quote, 'culture eats strategy for breakfast', we would argue, 'culture can also eat shareholder value for lunch and dinner'. Therefore, in our view, it is important that investors do not solely look at culture as an HR issue that is value additive to a company, but also consider the broader financial implications of culture-based financial risks. As outlined in this paper, culture-based financial risks can extend past an investee company and have implications at the systems level, leading to long-term and widespread risk for universal investors.

Similar to climate change risks, culture-based financial risks are also materialised and exacerbated by the fast and often unpredictable shift in societal norms and regulatory changes. These risks are increasingly moving beyond reputation to becoming compliance and legal risks for companies. Investors can use engagement to encourage appropriate disclosure and action from companies that go beyond policies and self-assessments.

At the same time, companies should consider the broader impacts of harmful behaviours in their workplaces. These incidents can have long-term implications for their relevant sectors, and can potentially lead to significant impacts on the societies and economies where they operate. The framework and recommendations provided in this paper can help companies understand these risks from a different lens.

Finally, it is critical to acknowledge that a safe and respectful workplace is also a matter of human rights. All workers have the right to physical and psychological safety at work, and managing culture-based financial risks will help companies to better protect these human rights. Our framework sits in the broader context of human rights management, and we hope that this framing will help bring the investor voice to these conversations and enable better communication and action from all stakeholders involved.

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